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China as an Alternative Source of FDI: Analyzing The Cases in Indonesia

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ABSTRACT: As China is strengthening its global position, it has gradually begun to exert its influence in the world economy. This can be observed in its move as investors to countries on the Asia and Africa continents, a position used to be dominated by western countries and institutions, as seen in the International Monetary Fund . However, China's rising economy and influence have allowed itself to become an alternative source of funding for many countries formerly dependent on the International Monetary Fund, on other western related countries or on particular institutions due to the restrictions the loans carry. Countries such as Indonesia views China as an alternate source for their foreign direct investment, manifested in the construction of the Indonesian High Speed Rail project, the projects of Huawei, and in the Indonesian energy sector. China's potency to enter into and expand in Indonesia is supported by the lack of restrictions towards the funding, if compared to the ones provided by western institutions. As a result, China has successfully presented itself as an alternate choice for many countries who wish to seek financial support to further their development.

Keywords: China, Foreign Direct Investment, Indonesia

INTRODUCTION

Since the Industrial Revolution, the West has always been the major players in the global economy. For more than two centuries, countries such as Britain, France, and Germany have dominated over Europe and the rest of the world to the shift of economic power towards the United States during the first and particularly the second World War. Their dominance over the world's economy is reflected in the economic institution the world has been following (Appiah-Kubi et al., 2021; Zimnoch, 2016). The situation remained largely unchanged as the USSR played another crucial role in global economy until its collapse in 1991.

This ushered in a period of uncontested global domination by the West, especially the United States (US). For the past few years, China is now challenging the dominance with an economy of US$14.72 trillion, the country is catching up with the US's US$20.94 trillion. In 1978, when China started its economic reforms, the nation's GDP stood at a meager US$149.5 billion compared to the US's US$2.352 trillion (Data Commons, 2022). It has been progressing significantly and is expected to catch up to the US GDP in and around 2030 (Wang, 2013; Zhu & Ye, 2018).

The threat toward Western hegemony is emerging not only from China's growth, but also from its global influence in the economic growth. It is likely that China is exerting its influence of its economic dependence through trade and more importantly through investments such as foreign direct investment (FDI) outflows (Yu & Li, 2020).

The way the FDI is set up signifies two sides to interact. China has successfully done so in multiple countries with various political, economic, and socio-cultural conditions, all of which have managed to interact and receive FDI from China. The success is evident in China's FDI outflow, which has substantially increased over the years. Between 2003 and 2013, China's FDI outflow increased 13.7 times, from US$45 billion to US$613 billion. This is also reflected in how Chinese companies have acquired stakes or outright bought some foreign companies (Tencent and multiple game developers, Ninebot, Segway, etc.) and also how Chinese companies have expanded abroad in not only exporting products, but also moving those production abroad and providing services (Alibaba group, Xiaomi, etc.). The expansion of Chinese companies is just one of the many symptoms of China's growing economic power (Guo et al., 2017; Leffel & Acuto, 2018).

Further investigation is then directed to a question, how has China become an alternative source of FDI? In light of China's growth, it is intriguing to explore more about how China became an alternative source of FDI, particularly in Indonesia. To respond to the main topic, this article will look at the core idea of FDI, assess China's FDI realization, and investigate numerous case studies of China's FDI in Indonesia.

METHODS

A case study approach to understand why China managed to invest in projects worldwide is implemented. The analyses is narrowed down to the case occurring in Indonesia. The reasons why Indonesia is chosen is, first the authors are originally from Indonesia, second is the country's reliance on China's investments is significantly increasing, despite some rejections from those who oppose the idea of China's dominance. As a matter of fact, Indonesia's economic and political conditions represent a wide range of countries that consider Indonesia as a developing region with a political system in between half democracy and half authoritarian. Thus, It is expected that the choice of country of interest represents both sides of the political consequences to back up the reasons why Chinese investments are much responded.

RESULTS AND DISCUSSIONS

1. China's FDI in Indonesia

Definition of FDI

According to OECD iLibrary:

> FDI is a category of cross-border investment in which an investor resident in one economy establishes a lasting interest in and a significant degree of influence over

> an enterprise resident in another economy. Ownership of 10 percent or more of the voting power in an enterprise in one economy by an investor in another economy is evidence of such a relationship (O.E.C.D., 2022).

FDI is opted for the benefits of both the investing and the receiving countries. For the investor, the trade effects of FDI depend on whether it is undertaken to gain access to natural resources, to consumer markets, or whether the FDI is aimed at exploiting local comparative advantage or other strategic assets such as research and development capabilities. For the receiving country, it influences the income, production, prices, employment, economic growth, development and general welfare(Kok & Ersoy, 2009).

There are three determinant variables which drive the investor's selection of the recipient country : "(1) the profitability of the projects; (2) the ease with which subsidiaries' operations can be integrated into investors' global strategies; (3) the overall quality of the host country's enabling environment" (Kok & Ersoy, 2009).

According to (Hansen & Rand, 2006), FDI appears to be growth enhancing much in the same way as domestic investment. A higher ratio of FDI in gross capital formation has positive effects on both the level of GDP and the growth. FDI has a significant long-run impact on GDP respectively of the development level. The highlight is as described below:

> FDI is a key element in international economic integration because it creates stable and long-lasting links between economies. FDI is an important channel for the transfer of technology between countries, promotes international trade through access to foreign markets, and can be an important vehicle for economic development (O.E.C.D., 2022).

China's Growth and the use of its Wealth

Since China began to open up and reform its economy in 1978, GDP growth has averaged almost 10 percent yearly, and more than 800 million people have been lifted out of poverty. There have also been significant improvements in access to health, education, and other services over the same period.

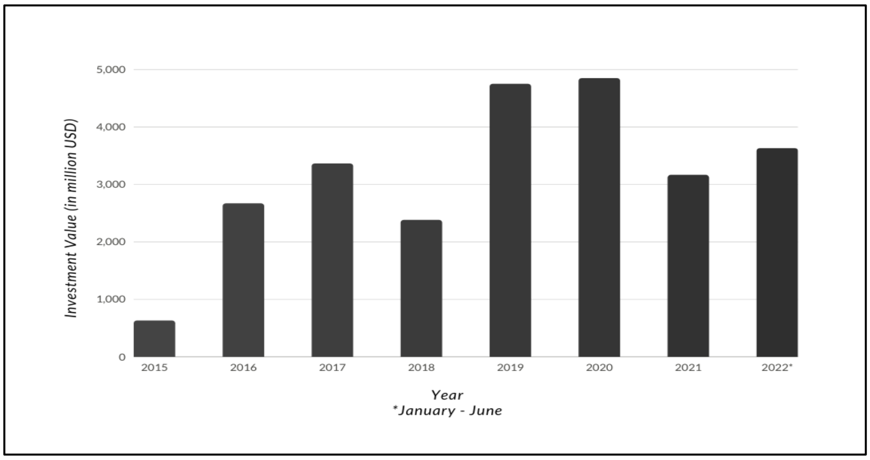
The growth is undeniable, from which China has encountered a period of excess capacity at home. This has allowed China to spend it on expensive initiatives like the Asian Infrastructure Investment Bank (AIIB), the BRICS Bank, and the 'One Belt, One Road' initiative (Dollar, 2017). This is evident in China's investment numbers, as between 2004 and 2013, China's overseas investments increased 13.7 times, from US$45 billion to US$613 billion (Zhou & Leung, 2015).

The Drivers of China's FDI

Reflecting on the international business discourse, there are five general motivations that push business actors to conduct direct investments: to seek natural resources, to expand the markets, to apply new technologies, to contrive the assets, and to diversify the risk (Deng, 2004). At the beginning, the primary strategy of China's direct investment was to seek natural resources from other countries as it needed fuel and industrial raw materials to support its domestic economic growth (Gammeltoft & Tarmidi, 2013). Once China gets enough resources and is able to gain a significant excess of production capacity, Beijing starts to put emphasis on the 'Go Global' policy to encourage its companies to expand into the international market. Further on, China joined the WTO in 2001. (Hong & Sun, 2006) noted that the aforementioned momentum has raised approval ceilings and relaxed many trade restrictions, shifting the government's attitude to be more friendly in the commercial field. The phenomenon further reaffirms that the government played a significant role in driving China's FDI maneuver, which has been pointed out by (Deng, 2004) as one of the unique features of China's FDI. Moreover, as the amount of FDI increases and the actors are getting more diverse, China's initial strategy on FDI expands to a wider range of objectives, such as seeking broader markets and new technologies.

China's FDI in Indonesia: Trends and Prospects

Figure 1. Realization of China's FDI in Indonesia during 2015-2022



Source: Indonesian Investment Coordinating Board, 2022

In recent years, China has been investing large amount of funds in Indonesia. China's FDI realization in Indonesia is relatively high, and it maintains to stay in the similar level, even getting higher in 2022 (see Figure 1). According to the Indonesian Investment Coordinating Board, the value of China's FDI in Indonesia has now reached US$3.62 billion with a total of 1,020 projects from January-June 2022, preserving its position as the second largest foreign investor in Indonesia after Singapore (Hennida, 2021). To further assess the strategy, it is essential to examine the past trends and future prospects of China's FDI in Indonesia first.

Since the establishment of the People's Republic of China in 1950, Jakarta and Beijing have developed diplomatic ties (Suryadinata, 2017). After 1950, the political relations between the two nations experienced a turbulence. It is undeniable, however, that both countries have mutual needs in the economic sector. From 1966 to 2007, the total realization of China's FDI in Indonesia have already amounted to 82 projects with a value of US$229 million (Gammeltoft & Tarmidi, 2013). It should also be noted that most of the investments are concentrated in the manufacturing sector, while the absorption in other industries is relatively small. Furthermore, From 2007 until 2014, during the presidency of Susilo Bambang Yudhoyono, Indonesia and China had set up a Strategic Partnership agreement in which the two countries emphasized the need to strengthen their cooperation in various fields, including the economy (Negara & Suryadinata, 2018). Furthermore, China began to invest in major joint projects such as the construction of Suramadu bridge and power plants. From 2014 up to today, China's FDI as the top foreign direct investor in Indonesia has increased more drastically, from position 9 to position 2 in 2016. China's investment is expanded further as President Joko Widodo's administration has prioritized infrastructure development, in which China is becoming more involved in a number of joint infrastructure projects, including the Jakarta-Bandung high-speed railway project (Hennida, 2021).

Now, exacerbated by the COVID-19 pandemic, China's FDI is expanding to broader sectors, such as digital technology. The shift in the investment sector is also inextricably linked with the change happening in China's economy, longer relies on domestic production and exports but has penetrated the digital technology sector. In Indonesia, China's companies have made investments in several major e-commerce firms (Rakhmat, 2022). Beside investing in Indonesian companies, China also participates in digital technology-related projects such as developing 5G infrastructure. As a country currently intensifying its digital transformation, China's prospects of investing in the digital technology sector in Indonesia are very visible, particularly in the next few years.

From the Indonesian viewpoint, China's FDI has been seen favorably as an economic source. During the administration of President Joko Widodo, the bureaucratic status of the Indonesian Investment Coordinating Board was elevated to the Ministry of Investment, and as a result, the Ministry of Investment now has greater authority to create investment-related legislation (Liu & Lim, 2023). Additionally, Indonesia's House of Representatives approved Act No. 11 of 2020 on Job Creation, which features more lenient investment laws and is anticipated to draw more international investors. Consequently, Indonesia's openness towards FDI also became one of the determinants of the possibility of China's FDI continuous growth in Indonesia.

China and Its 'Go Global' Policy

The 'Go Global' policy was formally promulgated in 2000, through several government documents and the construction of a series of regulations that encourage Chinese companies to invest and conduct business abroad (Luo et al., 2010). The policy is expected to raise the competitiveness of Chinese goods on the global market, promote structural upgrading or foreign trade, and propel the manufacturing and financial sectors to a medium-high level (Tiezzi, 2014). In essence, the 'Go Global' policy is a component of China's effort to restructure its economy and move away from a reliance on domestic manufacturing and exports (Tiezzi, 2014). As (Hong & Sun, 2006) stated, the 'Go Global' policy is one of the critical drives that enable China to "adjust itself to the trend of economic globalization".

2. Case Analysis

China's rise and growth as a power of economic importance, as well as its policy in growing abroad have been investigated. The next analyses are connected to China's involvement in financing development in Indonesia via observation of projects as well as general phenomena of growth and investment. The purpose is to understand how China promotes itself towards Indonesia, and why Indonesia chooses China as a source of investment.

Jakarta Bandung High Speed Rail (HRS)

The Jakarta-Bandung High Speed Rail is one of the strategic partnership programs between Indonesia and China, executed under the Chinese Belt and Road Initiative (BRI) (MoFA, 2022). Its main goal is to create a high speed rail connecting the Indonesian capital of Jakarta, to the neighboring city, Bandung, with stops in between. The Indonesian Minister of Transportation underlined the key role that the HRS plays as a part of comprehensive partnership between Indonesia and China. Here, China's investment is crucial towards the HRS's development. The investment put forth by China in this project approximates to US$4.3 billion and was to begin the project construction by 2017 (K.P.P.I.P., 2022). It was agreed that the construction of the HRS, in part, will be done by a subsidiary corporation of the China Railway Construction Corporation (CRCC).

In fact, infrastructure development has become a key interest and is a part of Indonesia's wider policy of 'Rencana Pembangunan Jangka Menengah' or 'Medium Term Construction Plan' of 2015-2019. The Jakarta-Bandung HRS is one of the largest projects under this context. Due to its size, the project originally enticed both Japan and China and both competed for tender for the project in September of 2015. China won the bid with a contract of US$5.9 billion with Kereta Cepat Indonesia Cina (KCIC), a company jointly owned by China Railway International and four other Indonesian construction companies (Purba & Purba, 2020).

The China's success in winning the bidding for the Jakarta-Bandung HRS project in Indonesia can be understood by observing two things; the first is the leniency in which China gives out its investment compared to Japan as well as the strong will from Indonesia to complete the project. The second is that the China's loans do not require any sort of official financing or extra cost from the Indonesian government. Both aspects can be seen as the major keys in China's success in winning the bid (Purba & Purba, 2020).

Following its achievements, China decided that the Jakarta-Bandung HSR will be funded via the China Development Bank, in which the loans provision was up to 75% of the total project, with the remaining cost being funded by individual companies via joint ventures. In addition, China has also suggested that the project be done business-to-business, where Indonesia would hold 60% stock in the venture, and China would hold 40% (Purba & Purba, 2020). This became an enticing proposition to the Indonesian government, who considered the project as a medium to achieve their national construction agenda.

Chinese investments in general are characterized by loosely regulated loans and significant funding for investment. Chinese ambition of the economic expansion can be seen as parallel towards that of Indonesian development. The Jakarta-Bandung HRS has been planned for construction since 2010, nevertheless there were delays in the project concerning the approval of the construction that it should begin in July 2015. The realization however, implemented in the beginning of the year 2019.

Huawei

Huawei has promised to increase its commitment in the Asia Pacific region, stating its optimism in regards to the company's prospects in the region. The Asia Pacific region is the most populous area in the world, and is seen as a key role in economic growth as well as playing a pivotal role in digital innovation. Particularly in Indonesia, Huawei has committed to train 100.000 digital talents over the next five years in order to work for the Indonesian government's Presidential Executive Office (Priyandita et al., 2022).

Since the mid 2000s, China's IT companies have started to build venues for training and partnership between telecommunication companies and local universities in Indonesia in order to train future engineers and tech specialists in Indonesia. In this sense, Huawei has also been able to position itself to be one of the primary companies to offer cyber security services to Indonesia's government (Thorhauge, 2020). Indonesia's trust on Huawei can also be shown in its meeting with Indonesian Minister of Investment, Luhut Binsar Pandjaitan who discussed the possibilities of projects related to Indonesian cities being transformed into 'smart cities' (Jayanty, 2022).

The increasing cooperation between Indonesia and Huawei can be understood through the view that South East Asia is a major actor in global economy, and Indonesia as a key player in South East Asia. With both South East Asia and Indonesia experiencing massive growth in their digital economy, the digital economy growth in South East Asia is expected to reach US$1 trillion in 2030 (Bain & Company, 2021), whereas in Indonesia the use of economic digital activity is expected to rise from US$70 billion in 2021 to US$146 billion in 2025. In this case, it is the Indonesian pattern of internet consumption - a number that has grown extensively over the years - that has set up Huawei as a digital transformation force. The possibilities and influence of Huawei can be seen in the positive response of the Indonesian government towards Huawei, in particular the Indonesian Minister of Tourism and Creative Economy, Sandiaga Uno who stated that Huawei can serve as the technological provider necessary to relight the spark of tourism in Indonesia following COVID-19 (Taufiqurrahman, 2022). On the other side, Indonesia favors Huawei as a company to rely on when it comes to cyber security due to its more reasonable prices and the previous investments in Indonesian vocational training (Priyandita et al., 2022).

China and Indonesian Energy

Indonesia, like many other countries, has considered the growth towards its energy needs alongside with the growth of its population and economy. A number of countries have contributed to the development of energy power plants in Indonesia. China as an investor to Indonesia's energy came relatively late, with the first energy project being completed in 2011 under the Shenhua Group (Li, 2018). China's growth however, far exceeds that of other countries. In 2015, about 17,300 MW of energy in Indonesia was produced under Independent Power Producers (IPP). Today China's accounts have reached 46% of the 17,300 MW energy production (Mori, 2021).

Amongst the projects that are currently being invested by China are the Java steam coal plants implemented in collaboration with the Chinese Shenhua Guohua and the Indonesian Pembangkit Listrik Negara (PLN) subsidiaries. The project places 70% of stock owned by China and the rest by Indonesia. In addition, there is the Hydropower plants in Poso, Central Sulawesi. While the Plant is constructed by an Indonesian company, the turbines used for its construction are directly imported from China. At the same time, China has also increased their imports of Solar components to Indonesia (Mori, 2021).

It is obvious that the increase of Chinese investment in Indonesia can be understood by the fact that China has been able to provide competitive prices on technology, a simpler method for procedure, and has been willing to take more risk in order to become more approachable. Moreover, China is capable of offering better, more interesting business proposals to Indonesia, compared to other options within the international market. Finally, the state owned enterprises that account for the majority of the Chinese investments have high flexibility when it comes to finances, and in general are more likely to accept risky projects, as long as the host country commits to credit guarantees (Mori, 2021).

CONCLUSIONS

Based on the observations made in the cases of China's investments formerly explained, it can be understood how China has been successful in becoming a new source of FDI. The amount of investments being offered by China has been able to entice countries away from the more traditional sources of loans and investment from western countries. As for the wisdom in its policy, it can also be determined that China's investments does not come with the rules and restrictions as those present in the western countries. Therefore, the policy is considered more inclusive, with a high degree of flexibility when projects are conducted, if compared to other investing countries. Finally, China's investment orientations to more business centered investments where the finances flow more easily would mean that there will more countries being unable to meet the demands and restrictions of western countries. As countries prone to changes in political, economical, and environmental sectors, China's investment is valued more highly. In conclusion, it can be emphasized that China's flexibility in investment allowed by its surplus of wealth has become crucial, and made China a potential country to be regarded as an FDI alternative on the world stage.

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